# NOTES

## BANKING INFLATION AND REDISCOUNT RATES

How serious the inflation of banking credit has become can be seen from figures and estimates prepared by the Federal Reserve Board and published in the *Federal Reserve Bulletin* for October. The figures in question represent the situation at the close of the last fiscal year on June 30, 1919. Of the 16,304 million dollars of Liberty bonds then outstanding, national banks owned about 770 millions, while other member banks reported a net investment of 293 millions in those securities. It is estimated that the banks outside of the Federal Reserve system held about 400 millions, making the amount held by all the banks on that date somewhat less than 1,500 millions, or about 9 per cent of the total outstanding. Of the Victory notes the amount owned by the national banks on June 30 is reported as 405 millions; other member banks gave their holdings of these notes as 192 millions, while the banks outside the Federal Reserve system, it is estimated, held about 250 millions of these securities. About 847 millions or 25 per cent are thus shown among the banks' holdings. Of the 3,634 millions of Treasury certificates outstanding on June 30 about 1,760 millions belonged to the banks. Thus an estimated total of 2,495 or say 2.5 billions of war paper was held by all the banks of the country.

Taking the figures as a whole, it would seem that at the close of the fiscal year there were at least 6.5 and probably 7 billions of war obligations in the banks. Today there are at least 500 millions more than this figure. This showing of inflation is being reflected in the weakened reserves of Federal Reserve banks, which at the close of October are well below 50 per cent, or under any figure reached during the war.

A decline of reserves and an increase of note currency in most of the European counties during September and October again illustrate the growth of inflation. In the stock market inflation is being displayed in a very high renewal rate for call loans, exceeding in its extremes during the month of October the extremes of fluctuation during disturbed prewar years.

As a remedy for this evil in our own country the natural suggestion first to be made is that of raising the rate of rediscount at Federal Reserve

banks. Those who advocate such a course naturally do so because they believe that an increase of rates would tend to conserve funds, raise reserve percentages, discourage unnecessary loans, and reduce speculation. This is the normal effect of an advance of rediscount rates in ordinary times. The discussion of the subject now in progress in Washington, however, has to take account of a number of unusual factors. Of these, the most immediately pressing is the fact that the Treasury Department, although it has closed the series of Liberty loans, is still getting great sums of money from the banks. An advance in rediscount rates would result in a largely increased cost of conducting government finance, since it would oblige the department to meet the increase by advancing its rate of interest on certificates of indebtedness in very much the same measure as the rate on rediscounted paper. This means of course that the expense of the public debt service would be considerably augmented.

This increase, taken alone, is not a conclusive reason against such a course of action. The problem, however, involves other elements. Most important is perhaps the doubt whether a mere advance in rediscount rates would check the use of reserve-bank funds for speculation. Probably it would not, and hence it is suggested in influential quarters that what is really required is not so much an advance of rates as it is action designed to cut off largely or wholly the discounting of paper whose proceeds are intended for use in speculation. The application of such a rule would be complex and difficult, but its effects should be more decisive than those of an advance in rates.

Increase of rates, however, will probably be necessary for other reasons. The time has come, as is indicated by the Federal Reserve Board in a statement on the subject, for restoring the functions of the central reserve banking mechanism. Since the organization of the reserve system there has been only a period of about four to six months just prior to the entry of the United States into the war when there was a really "effective" discount rate at Federal Reserve banks. All indications point to a belief that the time for restoring such an effective rate is recognized as having arrived.